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September 28, 2011

Via E-mail and FedEx

The Honorable Battle R. Robinson
104 West Market Street
Georgetown, DE 19947

Re: *In Re: The Proposed Affiliation of BCBSD, Inc. Doing Business as Blue Cross Blue Shield of Delaware, with Highmark Inc, Docket No. 1509-10.*

Dear Judge Robinson:

As indicated in our letter to you of September 16, BCBSD opposes the introduction by the Delaware Department of Justice ("DOJ") into the record of the present proceedings of the document entitled "Presentation to The Delaware Department of Justice Regarding The Public Benefit Asset" authored by Grace Global Capital, L.C.C. (the "Grace Report"), as well as any testimony premised on its contents. In addition, we note that the DOJ has devoted its Prehearing Memorandum exclusively to its insistence that \$45 million be severed from BCBSD's surplus as a condition to the Commissioner's approval of the transaction. Because we do not believe that the issue has any place in this proceeding we are asking that Your Honor rule on the admissibility of the Grace Report, and the propriety of the DOJ's proposed condition, prior to the commencement of the public hearing next week.

As Hearing Officer, you have the clear authority to strike the proposed exhibit and testimony that is not pertinent to the hearing: Paragraph 8 of the Commissioner's Pre-Hearing Order dated October 20, 2010 (the "Pre-Hearing Order") provides in part that "Any testimony or documentary evidence which the Hearing Officer determines does not address a matter within the scope of the hearing is subject to exclusion by the Hearing Officer", and Section 10117(1)c. of Title 29, Delaware Code, which governs the hearing absent any contrary instruction in Title 18, provides that the Hearing Officer is empowered to "Exclude irrelevant, immaterial, insubstantial, cumulative, privileged matter..." In the matter at hand, the objected to documentary evidence and testimony is irrelevant, and therefore does not "...address a matter within the scope of the hearing..."

The single purpose of the upcoming hearing is set out at paragraph 8 of the Pre-Hearing Order:

The purpose of the hearing is to determine whether the Commissioner should approve the affiliation of BCBSD with Highmark. In making such determination, the Hearing Officer shall apply the specific criteria for approving or disapproving a change of control of a domestic insurer found at 18 *Del. C.* §. 5003(d)(1), and the Parties consent to these criteria being employed in this matter.

That the Report and any testimony premised on it are irrelevant to the criteria found at Sec. 5003(d)(1) is beyond doubt; indeed, the DOJ has admitted as much in its letter of September 26th (“The DOJ’s review of the Proposed Affiliation is not limited to the criteria enumerated in Chapter 50 of Title 18 of the Delaware Code...”). Moreover, the Report itself states unequivocally that it is intended for an entirely different purpose:

Grace Global Capital understands that the DOJ is submitting this report on the record for the general purpose of estimating what the value of the Public Benefit Asset of BCBSD would have been had the Proposed Affiliation been effected as a conversion, and also for reference should any future conversion be contemplated.

Grace Report, p. 5. Despite its dual status as a Party and signatory to the Pre-Hearing Order, DOJ in its letter to Your Honor of September 26 and in its Pre-Hearing Memorandum, now insists that the broad *parens patriae* authority of the Attorney General, to wit, his authority “to protect the charitable trusts and assets held for the public benefit in this State” found at 29 *Del. C.* §. 2533(k), invests the Hearing Officer with the right to exceed the jurisdictional parameters imposed by the Commissioner in this matter (agreed to by all of the Parties almost a year ago), and to consider the DOJ’s proposed condition on the strength of this broader authority. We disagree.

Your Honor’s authority is derived exclusively from the delegation made by the Commissioner in her appointment of Your Honor to your present role, which delegation is expressly limited to the consideration and application of the criteria enumerated at 18 *Del. C.* §5003(d)(1). The Commissioner, in turn, derives her authority and responsibilities purely from Title 18. It is manifest therefore that matters properly considered in this proceeding are those that come within the Commissioner’s authority under Title 18. Yet, in its Pre-Hearing Memorandum, the DOJ candidly admits that the condition it seeks is beyond the scope of the Commissioner’s authority:

Therefore, the DOJ’s role extends beyond the impact of a change of control on the insurance buying public or policyholders to matters beyond the purview of the DOI, including the impact on the public as a whole as to matters that would not trigger the DOI’s protection (e.g., protection of the assets accumulated through the public’s subsidy).

DOJ Pre-Hearing Memorandum at pg. 12. Whatever authority the Attorney General may have under Title 29 or the common law, a controversy involving such authority falls wholly outside the jurisdiction of the Hearing Officer in this proceeding, as established under the four corners of the Pre-Hearing Order, and as now conceded by the DOJ.

In its Pre-Hearing Memorandum, the DOJ makes multiple references to the newly adopted 18 *Del. C.* § 6311(b), which provides as follows:

(b) If a health service corporation regulated under this chapter proposes to enter into a transaction in which it will become controlled by another entity, the Insurance Commissioner shall place conditions upon any approval of the change of control intended to preserve that amount, determined in accordance with Delaware law, that constitutes the surplus or reserves of the health service corporation. Such conditions shall include, without limitation, requiring:

(1) Review and approval by the Department of Insurance of any change in the certificate of incorporation of the health service corporation;

(2) Review and approval by the Department of Insurance of any individual expenditure or transfer of funds or coordinated series of expenditures or transfers of funds by the health service corporation in excess of \$500,000 to the controlling entity or any affiliate of such controlling entity, which review and approval shall assess the commercial reasonableness of the proposed expenditure or transfer;

(3) A majority of the board of directors of the health service corporation to consist of persons not employed by the health service corporation or any of its affiliates who are residents of Delaware and have been so for at least 5 years prior to appointment; and

(4) Recognition of, and consent to, the ability of Insurance Commissioner to seek appropriate relief from the Court of Chancery or other court of appropriate jurisdiction to prevent the entity controlling the health service corporation from improperly using the assets of the health service corporation for the benefit of the controlling entity rather than the benefit of the health service corporation and its subscribers, or otherwise violating the terms of this section, Chapter 50 of this title, or any agreement between the health service corporation and the controlling entity or affiliate thereof.

Based on this new statute, it is beyond argument that Your Honor may, indeed must, consider mechanisms designed to preserve BCBSD's reserves or surplus. Accordingly, the Department of Insurance, in its Pre-Hearing Memorandum, has proposed multiple conditions designed to ensure that BCBSD's surplus cannot be improperly accessed or used by Highmark post-closing. The imposition of such conditions is squarely within your authority under the Pre-Hearing Order because, by preserving the surplus of BCBSD and ensuring that it exists for the benefit of BCBSD subscribers and the insurance buying public (by ensuring that BCBSD remains solvent and able to pay claims), such conditions are directly relevant to the criteria set out on 18 *Del. C.* §5003(d)(1) and that are adopted by the Pre-Hearing Order. By contrast, the DOJ seeks a condition not for the purpose of preserving the surplus of BCBSD, but rather for the express

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purpose of *removing* that surplus (at least 25% of it) from BCBSD and devoting it to purposes unrelated to BCBSD's insurance business. Not only would such a condition go beyond the requirements of § 6311, it would appear to be in direct violation of these requirements.

Your Honor may also want to take judicial notice of the fact that the DOJ is attempting to resurrect in the proceeding *sub judice* the precise issue which it unsuccessfully raised in June of this year before the General Assembly. At base, the Attorney General would have the Hearing Officer recommend, and the Insurance Commissioner find, that a foundation should be created and funded with \$45,000,000 of BCBSD's assets, notwithstanding that the statute that might have triggered such a result—29 *Del. C.* § 2531(1)(c)—was expressly amended to exclude an affiliation between two, not-for-profit health care entities. It is wholly inappropriate to use this present proceeding to seek an outcome that the Delaware General Assembly has previously and emphatically rejected.

The DOJ has frequently reminded us over the course of this proceeding of its right to pursue independently and in the appropriate forum the protection of charitable trusts and assets. This right is in no way compromised by a finding that the Grace Report and allied testimony are irrelevant to this proceeding or that the DOJ's requested condition is beyond Your Honor's authority to recommend. The hearing scheduled to begin on October 5 is simply not the appropriate forum for the consideration of the issue raised and the relief sought by the DOJ. BCBSD respectfully request that Your Honor so find. BCBSD is authorized to represent that Highmark supports BCBSD's position in this matter.

Counsel for BCBSD are available for oral argument at Your Honor's pleasure, but suggest, for the convenience of all involved, that it be held telephonically.

Very truly yours,



DAVID S. SWAYZE



MICHAEL W. TEICHMAN

MWT:bfd

cc: See attached service list